

**Office of Thrift Supervision**


Department of the Treasury

Acting Executive Director, Supervision

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April 30, 1998

MEMORANDUM FOR: Chief Executive Officers

FROM: John E. Ryan 
Acting Executive Director, Supervision

SUBJECT: Continued Year 2000 Oversight

As part of our mission to maintain the safety and soundness of the thrift industry, the Office of Thrift Supervision is responsible for examining and monitoring industry efforts to adequately mitigate the risks associated with the Year 2000 computer problem. To fulfill our mission, we will continue to examine for Year 2000 preparedness through 1999 and into 2000 as needed, until all significant Year 2000 issues are resolved. Most thrift institutions share our view of the seriousness of this problem and are taking appropriate steps to ensure Year 2000 readiness. However, in those few instances where this is not the case, we will promptly initiate appropriate informal and formal enforcement actions to address problems and weaknesses. This memorandum discusses our approach to examinations and enforcement, highlights new interagency Year 2000 ratings, and sets forth the supervisory follow-up activities for institutions whose assigned Year 2000 rating is less than satisfactory.

OTS has adopted an interagency Year 2000 Report of Examination (ROE) that includes a three-tier Year 2000 rating system for compliance. Definitions for the three ratings levels – “Satisfactory,” “Needs Improvement” and “Unsatisfactory” – are provided in Attachment A. In brief, the “Needs Improvement” rating indicates less than satisfactory performance in any of the key phases of a Year 2000 project management process, and “Unsatisfactory” indicates critical deficiencies and overall poor performance with respect to the Year 2000 remediation process. We will conduct supervisory follow-up activities at all institutions whose assigned Year 2000 rating is “Needs Improvement” or “Unsatisfactory” until underlying weaknesses and issues have been resolved, and the Year 2000 rating has been upgraded to “Satisfactory.”

The May 1997 Policy Statement issued by the Federal Financial Institutions Examination Council (FFIEC) on Year 2000 Project Management included an interagency examination program and announced that the FFIEC agencies had committed to performing Year 2000 examination work at all of the financial institutions they regulate by June 30, 1998. Rather than beginning on-site examinations at that time, the OTS devised an examination strategy that called for preliminary off-site examinations to gather information that would help us

understand the thrift industry's exposure to Year 2000 matters and more effectively plan our on-site examinations. Based on responses to Preliminary Examination Request Kits (PERKs) sent out by regional offices in May 1997, OTS examiners conducted off-site examinations of all thrift institutions regulated by the OTS between August and November 1997. Those examinations focused on the activities encompassed in the first two phases of a Year 2000 project -- "Awareness and Assessment."

We are now conducting a second round of examinations of all the thrifts we regulate. The examiners are focusing on activities encompassed in the "Renovation" phase of a Year 2000 project and plans for the "Validation" (also called "Testing") and "Implementation" phases.

Items of note regarding these examinations include:

- The examinations may be performed by Safety and Soundness (S&S) examiners or by Information Systems (IS) examiners. In general, IS examiners will conduct the Year 2000 examinations of large institutions with in-house data centers and those of any size with complex data processing environments or other unusual risk factors. Year 2000 examinations of some thrifts with in-house systems and many thrifts with turn-key operations will be performed by S&S examiners, who will also examine institutions primarily using third parties for data services. The Year 2000 examination work will be conducted with a regularly scheduled S&S or IS examination whenever that is practical or circumstances permit.
- In conducting the examinations, OTS examiners follow the FFIEC Year 2000 examination program issued in May 1997. The FFIEC agencies are revising that examination program to include more specific procedures related to testing and contingency planning.
- At the conclusion of each on-site Year 2000 examination, the Examiner-in-Charge (EIC) will assess the effectiveness of the institution's Year 2000 program and assign a rating of "Satisfactory," "Needs Improvement" or "Unsatisfactory."
- As part of the examinations, examiners complete an assessment which is entered into a national database that the OTS uses to report to Congress and the General Accounting Office and to monitor industry-wide Year 2000 conditions. The OTS intends to also use the information to identify concerns and topics that the OTS and other FFIEC agencies should address.
- Examiners may perform Year 2000 examinations at holding companies and thrift subsidiaries. Generally, this work will be focused on the potential impact of unresolved Year 2000 issues at the holding company or subsidiary on the thrift. No Year 2000

Report of Examination (ROE) will be created and no Year 2000 Rating will be assigned for the holding company or subsidiary. For thrifts controlled by multi-bank holding companies with centralized Year 2000 efforts, examination procedures will be coordinated with the lead agency for the bank holding company.

Some on-site Year 2000 examinations were completed before the OTS adopted the new ROE and Year 2000 rating. Regional offices will review those cases to determine whether it is appropriate to assign a rating based on the information contained in the existing ROE and work papers or whether additional information or examination work is necessary. If a rating is assigned, the regional office will communicate the rating to the institution's board of directors. If further information is needed, the regional office will contact the Chief Executive Officer to arrange to obtain additional information or to conduct a short supplemental field visit before June 30, 1998 so that a Year 2000 rating may be assigned and communicated to the board of directors. Regional offices will also assess on a case-by-case basis whether additional supervisory follow-up is appropriate for institutions with on-site Year 2000 examinations completed before the new ROE and Year 2000 rating.

As noted earlier, the OTS will continue to perform Year 2000 examinations at thrifts until all significant Year 2000 computer problems are resolved. At a later date, we will provide information on our strategy and procedures for examinations after June 30, 1998.

Supervisory Follow-up and Enforcement

The OTS has adopted new substantive guidance related to supervisory follow-up for those institutions whose assigned Year 2000 ratings are less than satisfactory. Required follow-up activities for these two ratings include:

- An examination (or post-examination) meeting with the board of directors;
- Written board of directors' response, which must include a board resolution
- showing time lines when correction will take place;
- The appointment of a board of directors' committee to oversee correction;
- Quarterly progress reports; and
- Quarterly field visits (brief on-site examinations).

For institutions with a Year 2000 rating of "Unsatisfactory," we have established a rebuttable presumption that an institution's Board will be asked to consent to a formal enforcement action to address Year 2000 problems. Depending on the circumstances, the formal enforcement action to be used for Year 2000 deficiencies would be a Supervisory Agreement, cease and desist order, temporary cease and desist order, civil money penalty or the appointment of a conservator.

Examiners will also consider the Year 2000 Rating in their assignment of the institution's "Management" component of the CAMELS and IS ratings and the composite CAMELS and IS ratings.

Year 2000 Examinations of Service Providers and Software Vendors

The OTS and the other FFIEC agencies have committed to performing on-site Year 2000 examinations by June 30, 1998, of all service providers and software vendors under their examination authority. Many of these examinations are done by interagency examination crews. Depending on several factors, including the number of financial institution clients, the types of applications serviced, and examination findings, examiners will revisit some of these entities on a regular basis after the initial on-site examination.

The OTS historically has provided copies of the IS ROEs on service providers to thrift clients of the service providers. We will continue that practice. We are also adding resources to an interagency effort to speed up the process of preparing, releasing and disseminating the IS ROEs. In addition, we have asked our examiners to update our national IS databases so that we may respond more quickly and effectively should problems surface with particular service providers, types of service providers, or types of applications. To check and update the databases, the examiners may include tracking forms or other information requests in the PERKs for Year 2000 examinations.

The IS ROEs of service providers may not be provided to financial institutions that are not existing clients of the provider.

Also, at present, the OTS cannot distribute IS ROEs on software vendors to anyone except FFIEC agencies.

Communication with OTS on Year 2000

Questions about how this guidance applies to your institution should be directed to a member of your supervisory team, that is, the assistant director, field manager, IS manager, or examiner who is assigned to your institution. General questions about Year 2000 may be directed to OTS's Year 2000 National Coordinator, Dorothy Van Cleave (202-906-7380) or its IS Program Manager, Jennifer Dickerson (202-906-5631).

This memorandum and the attached document will be posted to OTS's web site – www.ots.treas.gov/y2k. That web page includes numerous other Year 2000 items and links.

Attachment

YEAR 2000 EXAMINATION RATINGS

SATISFACTORY
<p>Year 2000 efforts of financial institutions are considered “Satisfactory” if they exhibit acceptable performance in all key phases of the Year 2000 project management process as set forth in the May 5, 1997 FFIEC Interagency Statement on Year 2000 and subsequent guidance documents. Performance is satisfactory when project weaknesses are minor in nature and can be readily corrected within the existing project management framework. The institution’s remediation progress to date meets or nearly meets expectations laid out in its Year 2000 project plan. Senior management and the board recognize and understand Year 2000 risk, are active in overseeing institutional corrective efforts, and have ensured that the necessary resources are available to address this risk area.</p>
NEEDS IMPROVEMENT
<p>Year 2000 efforts of financial institutions are evaluated as “Needs Improvement” if they exhibit less than satisfactory performance in any of the key phases of the Year 2000 project management process as set forth in the May 5, 1997 FFIEC Interagency Statement on Year 2000 and subsequent guidance documents. Project weaknesses are evident, even if deficiencies are correctable within the existing project management framework. The institution’s remediation progress to date is behind the schedule laid out in its Year 2000 project plan. Senior management or the board is not fully aware of the status of Year 2000 corrective efforts, may not have committed sufficient financial or human resources to address the risk, or may not fully understand Year 2000 implications.</p>
UNSATISFACTORY
<p>Year 2000 efforts of financial institutions are “Unsatisfactory” if they exhibit poor performance in any of the key phases of the Year 2000 project management process as set forth in the May 5, 1997 FFIEC Interagency Statement on Year 2000 and subsequent guidance documents. Project weaknesses are serious in nature and are not easily corrected within the existing project management framework. The institution’s remediation progress to date is seriously behind the schedule laid out in its Year 2000 project plan. Senior management and the board do not understand or recognize the impact that the Year 2000 will have on the institution. Management or the board commitment is limited or their oversight activities are not evident.</p>